



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **201230025**
Release Date: 7/27/2012

Date: May 2, 2012

UIL: 501.00-00, 501.03-05

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses at-1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: March 12, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

UIL: 501.00-00, 501.03-05

Employer Identification Number:

LEGEND

Clinic =
P1 =
P2 =
P3 =
P4 =
LLC =
State =
Date1 =
Date2 =
Month1 =
Month2 =
\$Range =

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3) of the Internal Revenue Code. The basis for our conclusion is set forth below.

FACTS

You are a State non-profit corporation created on Date1 and operate as a "pain management clinic" to provide "pain relief in an underserved community and for the relief of the poor and distressed." Your mission is "to help individuals with intractable pain get the pain medication that they need in order to enjoy an optimum life style, in accordance with the State Guidelines for Management of Pain." Your sole activity consists of providing prescriptions for pain medications for a fee.

P1 and P2, your owners and co-presidents, formed you as a State non-profit corporation; they are the sole members of your governing body and each has 50% control. Your Articles of Incorporation state that you organized "for charitable purposes in a low income and[] under-

served community.” You provided an addendum to your Articles that included the appropriate § 501(c)(3) purpose, inurement, powers, and dissolution language.

Successor Organization

You are a successor organization to a for-profit company, LLC, which was also a “pain management clinic.” P1 and P2 created and were the managing members of LLC. Two weeks before you incorporated, you leased LLC’s office space; LLC signed the lease as the guarantor. Then, on Date2, you purchased all of LLC’s assets for \$100.

You claimed that LLC ceased operations as of Date2 and there were no financial transactions between you and LLC after that date. However, you continued to use LLC’s bank account for your financial transactions, depositing your cash receipts and paying your expenses through LLC’s bank account. You explained that you did not open your bank account until the following month and that you used LLC’s bank account in the interim; you noted that your two officers were the signers on both accounts.

State shows LLC’s dissolution date almost one year after Date2. You explained that even though LLC did not renew its license, State has its own schedule to remove inactive companies from the published list. Your website address is the same as LLC’s, and the web pages display LLC’s name, services, and price structure. The website lists your phone and fax number, but not your name.

State Law Changes

State changed the registration requirements for pain management clinics, making them effective Date2. The law requires that all privately owned pain management clinics must register with the state unless they meet one of six exceptions. One of the exceptions is for clinics owned by a corporation exempt from federal taxation under § 501(c)(3) of the Internal Revenue Code. If a clinic does not meet one of the stated exceptions, it must have as an owner a licensed physician who can legally write prescriptions.

LLC did not fall under any of the exceptions and was not physician-owned because neither P1 nor P2 is a licensed physician. Therefore, P1 and P2 created you as a non-profit company to meet the state exception that allows an entity exempt under § 501(c)(3) to operate a pain management clinic without registering. Six weeks after Date2, the State Department of Health notified you of its intent to revoke your certification of registration because you had not received exemption from federal income tax under § 501(c)(3). The notice includes your registration number, which was the same registration number as LLC. You ceased operations in Month1.

Pain Management Services

You provide service to adults at least 26 years old. When patients come into your clinic, they complete registration forms and medical history reports. Patients must provide a current MRI and/or CT scan. You give every patient an initial drug screening and conduct random screenings, dismissing patients when they test positive. After an examination, the physician will write a prescription for pain medicine, which the patient must fill at a pharmacy. You do not sell any drugs in your office. You do not provide any other services or treatments for the underlying condition or for pain management such as acupuncture, meditation, massage, or physical therapy.

You first stated that your hours of operation were Monday through Friday 9:00am to 5:00pm. However, on your pain clinic registration form for State, you wrote that you remain open until 6:00pm and the schedule you submitted for your physician revealed that his hours varied. His office hours ranged from four hours on some days to ten hours on other days. You stated that the expanded hour were necessary because the community need increased when two pain clinics in your area closed.

The physician you employ part-time writes all prescriptions and is the same physician who worked for LLC. You do not have a written employment contract but pay the physician an hourly rate. In addition, you have two office employees, one of whom is a licensed medical assistant.

Like your predecessor LLC, your only source of income is your patient fees. LLC charged all patients the same fee for the initial appointment and the same amounts for follow-up appointments; you have the same fee structure. You state that you are different from LLC, because you have a charity care policy and donate money to local schools.

Your charity care policy consists of a sliding-fee scale based on household income and you state that you charge less for your services than your local competitors charge. You did not provide any basis or justification for the amounts in the schedule. You posted the fee schedule so your patients would see it and have the opportunity to take advantage of the benefit if they qualified. You explained that you do not have a bad debts policy because everyone must pay the fee before receiving services. You do not accept Medicare or insurance coverage.

You provided redacted copies of your patient invoices. They report the method of payment for every patient was cash and the amounts paid are equal to your full fee; none of the invoices reflected a lower fee. You explained that the majority of your patients are in the same wage bracket and did not qualify for reduced fees.

Your financial information does not report that you gave any funds to charity. You explained it was not possible to give funds to the community after the State Department of Health revoked your registrations and forced you to close.

Disagreements between P1 and P2

After you submitted your application for exemption, P1 and P2 disagreed over whether to continue your operations or to withdraw the application. In early Month2, P2 withdrew your application for exemption stating the corporation had dissolved. P2 also cancelled your business licenses with the city and county, terminating your ability to operate a pain management business in State within the law. P2 also dissolved the corporation with the state. P1 reactivated the licenses, revoked the dissolution with State, and revoked the withdrawal from us within two weeks.

In Month2, P1 stated that the board, comprised of P1 and P2, had voted out P2 as co-president earlier in the year. To support this claim, P1 submitted minutes from a board of directors meeting dated the prior month, which stated that P1 called a special meeting "to discuss removal [of P2] from the corporation." The quorum for the meeting included P1, P3, who holds your power of attorney, and is married to P1 (according to P2), and P4; according to the minutes, P2 was not present. The minutes state that the board voted to remove P2 as president.

When we asked when your board voted P3 and P4 onto the board, P1 submitted a second set of minutes for a board of directors meeting dated almost three months before the first minutes, stating that both P1 and P2 voted to add them to the board.

In a personal communication to the Service, P2 declared that she never resigned as co-president, did not transfer any shares to P1, and did not vote in additional board members; nor was she present at either board meeting because she said they did not take place. P2 states that P1 and P2 are your only two board members and officers.

P2 declared that P4 had been an investor in LLC and in return received one-third of LLC's profits every month. When you succeeded LLC, the payments to P4 continued until you ceased operations in Month1. According to P2, you and LLC made all payments to P4 in cash with the amounts varying each month, but always between \$Range. In your application, you only listed the salaries of P1, P2, and your physician; there was no mention of P4 or payments to him in either your application or your financial statements. Until the board of directors minutes previously referenced, none of the documents you submitted after the application ever alluded to P4's existence.

Finally, P2 stated:

I don't believe P3 and . . . P1 have the best interested [sic] in mind when it comes to this corporation and obtaining a nonprofit status. They have lied on the application regarding who exactly P4 is, they never showed his income on the . . . reports that were submitted and they never had the intentions to explain how P4 would continue to receive a monthly payout of profits with our corporation turning into a non-profit. As legal 50% owner and president of this corporation, I believe this corporation does not deserve a nonprofit status. The application process has consisted of too many lies and deceiving information in which I never approved or had knowledge of.

LAW

Section 501(c)(3) of the Internal Revenue Code ("Code") grants exemption from Federal income tax to organizations organized and operated exclusively for charitable purposes, provided no part of the net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations ("Regulations") defines "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(a)(1) states that an organization must be both organized and operated exclusively for one or more exempt purposes to qualify for exemption under § 501(c)(3). If an organization fails to meet either the organizational or the operational tests, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes and do not expressly empower it to engage, other than insubstantially, in activities which are not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(b)(1)(iv) states that an organization is not organized exclusively for exempt purposes if, under the terms of its articles, its purposes are broader than those specified

in § 501(c)(3). The fact that the actual operations of the organization are exclusively in furtherance of exempt purposes does not permit the organization to meet the organizational test.

Section 1.501(c)(3)-1(c)(1) provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3). An organization does not operate exclusively if more than an insubstantial part of its activities do not further an exempt purpose.

Section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for exempt purposes if any of its net earnings inure to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) states that an organization is not organized or operated exclusively for exempt purpose unless it serves a public rather than a private interest. Thus, the organization must establish that it is not organized or operated for the benefit of designated individuals or the persons who created it.

Section 1.501(c)(3)-1(d)(2) provides that the term "charitable" in § 501(c)(3) is used in its generally accepted legal sense. Charitable includes purposes such as the relief of the poor and distressed or of the underprivileged; the promotion of health has long been recognized as a charitable purpose. See *Restatement (Second) of Trusts*, §§ 368, 372 (1959); 4A Scott and Fratcher, *The Law of Trusts*, §§ 368, 372 (4th ed. 1989).

Section 1.501(c)(3)-1(e) states that an organization may meet the requirements of § 501(c)(3) although it operates a trade or business as a substantial part of its activities, if it operates the trade or business in furtherance of its exempt purposes. The organization must not be organized or operated for the primary purpose of carrying on an unrelated trade or business.

Section 1.501(c)(3)-1(f)(1) states that an "organization that applies for recognition of exemption under § 501(a) as an organization described in § 501(c)(3) must establish its eligibility under this section. The Commissioner may deny an application for exemption for failure to establish any of § 501(c)(3)'s requirements for exemption."

Rev. Rul. 61-170, 1961-2 C.B. 112, held that a nurses' association, which maintained an employment register primarily for the employment of its members, was not entitled to exemption under § 501(c)(3). The organization's primary purpose was to provide employment services principally for the benefit of its members. Public participation in the management and support of the organization was negligible. It drew its support primarily from members, and a board of trustees composed of professional nurses controlled the organization without public participation of any kind. Therefore, the organization was not free from substantial private considerations in the operation of the employment register.

Rev. Rul. 80-287, 1980-2 C.B. 185, held that a nonprofit lawyer referral service, which was open to all members of the community, did not qualify for exemption under § 501(c)(3). Providing services of an ordinary commercial nature, even though the undertaking is conducted on a nonprofit basis, is not regarded as conferring a charitable benefit on the community unless the service directly accomplishes one of the established categories of charitable purposes. Although the organization provided some public benefit, a substantial purpose of the program was the promotion of the legal profession.

In *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279, 283 (1945), the Supreme Court held that the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

"The general rule is that the reach of income tax [sic] statute is broad; that exemptions from taxation are matters of legislative grace and that exemptions must be construed with restraint in light of the policy to tax income comprehensively." *Holt v. Comm'r*, 364 F.2d 38, 40 (8th Cir. 1966).

"Tax exemptions are matters of legislative grace and taxpayers have the burden of establishing their entitlement to exemptions." *Christian Echoes Nat. Ministry, Inc. v. U.S.*, 470 F.2d 849, 854 (10th Cir. 1972).

In *Harding Hospital, Inc. v. United States*, 505 F.2d 1068, 1071 (6th Cir. 1974), the court held that an organization has the burden of proving that it satisfies the requirements of the particular exemption statute. The court noted that whether an organization has satisfied the operational test is a question of fact.

In *Airlie Foundation v. Commissioner*, 283 F. Supp. 2d 58 (D.D.C. 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because the organization conducted its activities in a commercial manner, the court found that it operated for commercial purposes, rather than tax-exempt purposes. Courts consider multiple factors when assessing commerciality, including evaluating the organization's competition with for-profit companies; the extent and degree of its below-cost services and pricing policies; the reasonableness of its financial reserves; its use of commercial promotional methods, such as advertising; and the extent to which it receives charitable donations.

In *United States v. Mubayyid*, 476 F. Supp. 2d 46 (D. Mass. 2007), the two defendants were indicted on charges that they knowingly and willfully schemed to conceal material information from the IRS in connection with their application for exemption under § 501(c)(3). An organization submits an application for exemption under § 501(c)(3) under penalties of perjury. To subject a person to criminal liability, any false statements must be "material." A materially false statement is one that has a natural tendency to influence, or is capable of influencing, the final determination of a government agency. "The government need not show that the agency was actually influenced by the statements involved." *Id.* at 52.

In *Easter House v. United States*, 12 Cl. Ct. 476 (1987); *aff'd*, 846 F.2d 78 (Fed. Cir. 1988), *cert. denied*, 488 U.S. 907 (1988), the court found an organization that operated an adoption agency was not exempt under § 501(c)(3) because the primary purpose of the agency was a nonexempt commercial purpose. The organization placed children for adoption in the same manner as a commercial adoption agency. The organization's sole source of income was the fees it charged adoptive parents; it did not receive contributions from the public. The relevant inquiry, the court noted, was whether the organization's primary purpose was to promote exempt purposes or business purposes; which is a question of fact. The court found "that the business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service [was] its primary goal." *Id.* at 485-86. Plaintiff competed with other commercial organizations providing similar services, thus coloring its activities with a commercial hue. Accordingly, the court held that the organization was not operated exclusively for purposes described in § 501(c)(3).

In *B.S.W. Group, Inc. v. Commissioner*, 70 T.C. 352, 356-58 (1978), the court stated that providing services at cost is not sufficient to characterize the activity as charitable as it lacks the donative element necessary. "[T]he critical inquiry is whether [the organization's] primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for [the organization]." Evidence of a "forbidden predominant purpose" includes such factors as the particular manner in which the organization conducts its activities, the commercial hue of those activities, and the existence and amount of annual or accumulated profits. The Court concluded that the petitioner was not an organization described in § 501(c)(3) because its primary purpose was not educational, scientific, or charitable, but commercial.

The organization in *The Church in Boston v. Commissioner*, 71 T.C. 102, did not meet the requirements for exemption under § 501(c)(3) because it made various grants to its officers and members, which did not further its religious exempt purpose. The IRS based the denial on two key facts. First, the organization's "records of past grants did not demonstrate any criteria which constituted an exempt activity." *Id.* at 104. Second, the organization gave the money without any legal obligation for repayment, resulting in a benefit to private shareholders or individuals. The organization did not "furnish any documented criteria which would demonstrate the selection process of a deserving recipient, the reason for specific amounts given, or the purpose of the grant." *Id.* at 106-07. "[F]ailure to develop criteria for disbursements of grants or to keep adequate records of each recipient can result in abuse." *Id.*

In *Federation Pharmacy Services, Inc. v. Commissioner*, 72 T.C. 687 (1979), the court found that the sale of prescription drugs to senior citizens and handicapped persons is a trade or business normally carried on for-profit. "The selling of goods, health or otherwise, at a discount, is not, of itself, a charitable deed." *Id.* at 692. The court said it is clear that petitioner's exclusive purpose for being is to sell drugs, an activity that commercial for-profit businesses carry on. Additionally, the court stated that many profit making organizations sell at a discount. The fact that the petitioner sold its drugs at cost did not alter the determination of non-exemption. Petitioner's sole activity was in direct competition with profit making drugstores, which were obviously commercially oriented. "The fact that the item sold bears a relationship to health care does not remove the commercial taint or make the competition with drugstores any less disabling. Certainly, [petitioner's] purpose of selling at a discount, as distinguished from below cost, smacks more of commercialism than of charity." *Id.*

RATIONALE

"Tax exemptions are matters of legislative grace and taxpayers have the burden of establishing their entitlement to exemptions." *Christian Echoes Nat. Ministry*, 470 F.2d at 854; *see also Holt*, 364 F.2d at 40. Based on the information you provided in your application and supporting documentation, we conclude that you are not operated exclusively for exempt purposes under § 501(c)(3).

An organization may be recognized as exempt under § 501(c)(3) only if it shows that it is both organized and operated exclusively for charitable, educational, or other exempt purposes. If an organization fails to meet either the organizational test or the operational test, it is not exempt. § 1.501(c)(3)-1(a)(1). Whether an organization is organized or operated exclusively in furtherance of an exempt purpose are questions of fact. An organization seeking tax-exempt status under § 501(c)(3) carries the burden of proving that it satisfies the requirements of the statute. *See Harding Hospital*, 505 F.2d at 1071. You do not satisfy the operational test of § 1.501(c)(3)-1(c).

Operational Test

You do not satisfy the operational test under § 501(c)(3) because you do not operate exclusively for exempt purposes. Only an insubstantial portion of an exempt organization's activities may further a nonexempt purpose. As the Supreme Court held in *Better Business Bureau of Washington, D.C.*, 326 U.S. at 283, the presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

Not Operated for Charitable Purposes

Section 501(c)(3) uses the term "charitable" in its generally accepted legal sense and defines the term "charitable" as including the relief of the poor and distressed or of the underprivileged. § 1.501(c)(3)-1(d)(2). Even organizations providing health care services, which is of great social value, must provide below-cost services to poor people. See *B.S.W. Group*, 70 T.C. at 360. You claim your operations are charitable because you benefit the community by providing a clinic in an underserved community, thereby making necessary medications available to the poor, distressed, and underprivileged, and you plan to donate profits to your local community and the local schools. You represent that you posted a sliding-fee scale based on household income and charge less for your services than your local competitors charge.

However, you did not submit any evidence to substantiate your claims of charitable behavior. You did not prove that you used the sliding-fee schedule, your deposit and invoice records do not show any patients taking advantage of it; and you failed to provide any basis or justification for the amounts. You explained that most of your patients fell within the same household income scale and were not eligible to take the discounts offered; however, you did not provide any documentation or proof that you have procedures to ascertain the financial status of your customers. Additionally, you have not demonstrated that your fees are low enough to relieve the distress of the poor, or that you limit your services to the poor. The invoices you provided us reveal that the rates you charge were the same as those charged by LLC.

We also requested documentation of your donations to the community and schools, however, the information you provided does not show that you distributed any funds to either your community or local schools.

You cannot claim to operate for the charitable purpose of promoting health as you do not provide any medical care or medications; you only provide prescriptions for medications, your patients must go elsewhere to fill them. You do not treat the medical conditions causing the pain, nor do you provide alternatives to drugs such as physical therapy, meditation, or acupuncture. Selling drug prescriptions for a fee, even in an under-served community or for a discount, does not provide relief to the poor and distressed. See *Federation Pharmacy*, 72 T.C. at 692. Therefore, you do not operate for any charitable purposes described in § 501(c)(3).

Commerciality

An organization can meet the requirements of § 501(c)(3) even if it operates a trade or business as a substantial part of its activities. § 1.501(c)(3)-1(e). However, the operation of the trade or business must further the organization's exempt purpose and the primary purpose cannot consist of carrying on an unrelated trade or business. That is, the organization's reason for conducting its sole activity must be for an exempt purpose, it cannot be to operate a business to

produce net profits. If that is the case, the organization will not receive exemption. See *B.S.W. Group*, 70 T.C. at 357-58.

If an organization's primary purpose is conducting a service that is commercial in nature, the service must directly accomplish an exempt purpose, regardless of whether the organization conducts the service on a nonprofit basis or as a benefit to the community. See Rev. Rul. 80-287, *supra*; see also *Better Business Bureau*, 326 U.S. at 283. There are multiple factors to consider when determining whether a primary purpose that has an ordinary commercial nature directly accomplishes an exempt purpose.

The way an organization conducts its activities and the "commercial hue" of those activities are relevant to determining a "forbidden predominant purpose." *B.S.W. Group*, 70 T.C. at 358. While promotion of health is a charitable purpose under common law, not every activity that promotes health furthers exclusively charitable purposes under § 501(c)(3). See *Restatement (Second) of Trusts*, §§ 368, 372 (1959). For example, selling prescription pharmaceuticals promotes health, but pharmacies cannot qualify for recognition of exemption under § 501(c)(3) on that basis alone. See *Federation Pharmacy*, 72 T.C. 687.

As the court acknowledged in *Federation Pharmacy*, if merely dealing in drugs converts an organization to an exempt organization under § 501(c)(3), "then so could a store selling orthopedic shoes, crutches, health foods, or any other product beneficial to health. Virtually everything we buy has an effect, directly or indirectly, on our health." *Id.* at 692. The law does not entitle an organization whose purpose is to benefit health to an automatic exemption, as Congress did not intend "to exercise its grace in such an expansive manner." *Id.*

As discussed above, you do not operate for an exempt purpose. Your sole purpose is the same as LLC's and you operate in the same manner, by providing your patients with prescriptions in exchange for a fee. You occupy LLC's old facilities and employ LLC's staff as your own. Your website advertises the same services and fees that LLC advertised. These activities are the same as those normally carried on by a commercial for-profit company and put you in direct competition with them.

Other factors to consider when evaluating commerciality include the extent to which an organization receives charitable donations and whether the organization provides free or below cost services. See *Airlie Foundation*, 283 F. Supp. 2d at 63. Your patient fees are your only form of revenue; you have not received any charitable contributions or any pledges of contributions upon exemption.

The existence and amount of annual or accumulated profits is another indicator of a "forbidden predominant purpose." *B.S.W. Group*, 70 T.C. at 358. The statement of revenues and expenses included with your application reports an estimated 48% profit margin for your first three years. The updated income statement you provided revealed an actual profit margin of 28% for your first year. You are similar to the organization in *B.S.W. Group*, which had a net profit of 10.8% even though it charged amounts lower than its competitors. The organization did not, nor did it plan to, "charge a fee less than 'cost.'" *Id.* at 360. The court noted that the organization resembled health care organizations that applied for exemption "on the ground that they provide medical services[,] which are of great social value. Despite the public benefit of the services provided, some degree of free or below-cost services to patients has generally been required to qualify these organizations as charitable before exemption has been granted under section 501(c)(3)." *Id.*

You are also similar to the adoption agency in *Easter House*, 12 Cl. Ct. 476, because your only source of income is your patient fees, you do not receive donations, or pledges, from the public, and you compete with other for-profit companies providing similar services. Your primary purpose is to carry on activities normally carried on by for-profit companies and in the same manner as your for-profit predecessor. Although you do not sell prescription drugs, you have a similar commercial hue because, for a fee, you provide a doctor who writes prescriptions for the treatment of pain.

Therefore, for these reasons, we conclude that you are not an organization described in § 501(c)(3) because your primary purpose is not charitable, but rather commercial and serves a substantial nonexempt purpose under § 1.501(c)(3)-1(c)(1). Any public purposes you may serve are only incidental to this primary nonexempt purpose.

Inurement

An organization operated exclusively for exempt purposes will not allow any net earnings inure to the benefit of private shareholders or individuals. § 1.501(c)(3)-1(c)(2). The Regulations define 'private shareholders or individuals' as people who have a personal and private interest in the organization's activities. § 1.501(a)-1(c).

An organization that gives money to any person should have fully developed criteria to determine the recipients of the funds. "[F]ailure to develop criteria for disbursements of grants or to keep adequate records of each recipient can result in abuse." *Church in Boston*, 71 T.C. at 107. It is your responsibility to prevent inurement to those with a personal interest in your activities. See *Easter House*, 12 Cl. Ct. at 487.

Your records and controls do not prevent inurement of your assets to insiders, nor do they demonstrate you are serious about preventing inurement. You only accept cash payments from your patients for your services; however, you do not have proper controls in place to process the cash or to govern spending by your officers. Your bank statements report purchases that you did not record in your financial statements or report on your application for exemption, and there are cash withdrawals that you could not document. For example, you paid multiple car expenses on behalf of P1 and P2, but did not list any automobiles on your financial statements. Additionally, every month your officers withdrew cash with their corporate ATM cards without documenting the expenses. You commingled funds with LLC by depositing your revenues and paying your expenses from LLC's bank account. Finally, P2, represented that you made monthly cash payments to P4 equivalent to approximately one-third of your monthly profits; if true, this also constitutes inurement of your assets to an insider.

We asked you about the officer's ATM withdrawals and requested the accompanying receipts or documentation of the purchases. You responded, "OK. These are craigslist and yard sale purchases. We try not to buy new and pay full retail. Cash is required for this transaction." You did not provide any type of receipt or proof of purchase for these purchases.

Because your net earnings inure to P1, P2, and P4, you are operating for a substantial nonexempt purpose rather than exclusively for exempt purposes. See § 1.501(c)(3)-1(d)(ii); Rev. Rul. 61-170, *supra*.

Private Benefit

An organization must operate exclusively for exempt purposes to receive exemption from Federal income tax. I.R.C. § 501(c)(3). The organization carries the burden of proving it operates exclusively for exempt purposes and not for the private benefit of its creators. § 1.501(c)(3)-1(d)(1)(ii). However, when construing the term 'exclusively,' the courts do not include 'solely' or 'absolutely without exception' in the definition. See *Church in Boston*, 71 T.C. at 107. "An organization [that] engages in nonexempt activities can obtain and maintain exempt status so long as such activities are only incidental and less than substantial.

When a change in state law made it more advantageous to do business as an exempt organization, P1 and P2 created you to take over LLC, your for-profit predecessor they owned. Your structure, financing, personnel, methods, and activities are the same as LLCs, and, as referenced above, you commingled your funds with LLC by depositing your revenues and paying your expenses from LLC's bank account. You have not instituted adequate financial and governance controls to ensure that you operate for public benefit; instead, there are multiple facts that demonstrate that you operate for the benefit of P1, P2, and P4 rather than the public. For example, you consistently bought meals for your employees and patients, gave patients gifts, made car payments for your officers, and allowed your officers to withdraw cash without supplying documentation of their purchases.

None of these activities further exempt purposes; they all provide private benefit to individuals and are more than incidental. Because you are operating for the benefit of private parties more than incidentally, which is a substantial nonexempt purpose, you are not operating exclusively for exempt purposes. See § 1.501(c)(3)-1(d)(ii); Rev. Rul. 61-170, *supra*.

Failure to Establish

An applicant for exempt status has the burden of proving "its entitlement to an exemption." *Easter House*, 12 Cl. Ct. at 487; see also § 1.501(c)(3)-1(f)(1). We may deny an application for exemption for failure to establish any of the exemption requirements specified in the statute and regulations. § 1.501(c)(3)-1(f)(1). A number of deficiencies, contradictions, and concealments in your application prevent us from concluding that you have met this burden.

Concealing material information about an organization's activities during application for exemption is illegal. *Mubayyid*, 476 F. Supp. 2d 46. The application form requires the name and income information of your five highest compensated independent contractors that receive or will receive more than \$50,000 per year. You did not reveal on your application, or in your financial records, that you paid one-third of your profits to P4. There was no mention of P4 until we questioned P4's presence on the board minutes that allegedly removed P2 from the board.

You must state on the application whether any officers or directors are related to each other through family or business relationships, and if so, list the relationship. You initially answered 'No' to this question, but if P3 was added as a member of the board as P1 claims, then you should have given us notice that P3 and P1 are married to each other. We learned of this relationship from P2 only after P2's fallout with P1. If this is true, this creates a conflict; your board, if comprised as P1 states, would be a small and connected board without independence.

Your bylaws state that your directors may be removed with or without cause "by the vote of a majority of the directors present at a meeting at which quorum is present." P1 states that a quorum was present when the board removed P2. However, according to P2, P3 and P4 were

not board members at the time of the vote. You did not submit any notice of the board changes until after we questioned P3 and P4 as voting members of the board.

These are examples of both private benefit and concealing material information. You have failed to establish that you operate exclusively for exempt purposes.

CONCLUSION:

Based on your application and the supporting documentation, we conclude that you do not operate exclusively for charitable purposes. As a result, you do not qualify for exemption as an organization described in § 501(c)(3).

You fail the operational test because you do not operate for an exempt purpose, but rather operate for commercial and private purposes. You operate a pain management clinic in a commercial rather than a charitable manner. Your pricing structure, staffing, and marketing is similar to a commercial operation. Your earnings inure in whole or in part to the benefit of your officers and private individuals, thereby precluding exemption under § 501(c)(3). See § 1.501(c)(3)-1(c)(2). Your officers P1 and P2 control you and your earnings inure to their benefit. You have not substantiated numerous payments as furthering exempt purposes and may have submitted false information on your application. Accordingly, we conclude you do not qualify for exemption under § 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Include the following declaration with your protest statement:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. You should make this request when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice Before the IRS and Power of Attorney*. You can find all forms and publications mentioned in this letter at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code § 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
Attn:
SE:T:EO:RA:
1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations